No. 92-516

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
Petitioner,

v.

DAKOTA GASIFICATION COMPANY AND
UNITED STATES OF AMERICA,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

BRIEF OF RESPONDENTS TENNESSEE GAS PIPELINE COMPANY, ANR PIPELINE COMPANY, AND NATURAL GAS PIPELINE COMPANY OF AMERICA

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QUESTION PRESENTED

Whether, notwithstanding the strong federal policy favoring arbitration, a forum selection clause in one contract may be invoked to force litigation of severable claims that arise under entirely separate but related contracts which themselves explicitly require arbitration?

STATEMENT REQUIRED BY RULE 29.1

The parent company of Tennessee Gas Pipeline Company is Tenneco, Inc. Autopartes Walker, S.A., Bordes Gas, Inc., Kern River Gas Supply Corporation, and Kern River Service Corporation are non-wholly-owned subsidiaries of Tennessee Gas Pipeline Company.

The parent of ANR Pipeline Company is American Natural Resources Corporation. ANR Pipeline Company has no non-wholly-owned subsidaries.

The parent of Natural Gas Pipeline Company of America is MIDCON Corporation and Occidental Petroleum Corporation is the ultimate parent of MIDCON. Natural Gas Pipeline Company of America has no non-wholly-owned subsidiaries.

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BRIEF OF RESPONDENTS TENNESSEE GAS PIPELINE COMPANY, ANR PIPELINE COMPANY, AND NATURAL GAS PIPELINE COMPANY OF AMERICA

Respondents Tennessee Gas Pipeline Company ("Tennessee"), ANR Pipeline Company ("ANR"), and Natural Gas Pipeline Company of America ("Natural") support the petition for certiorari filed by Transcontinental Gas Pipe Line Corporation.

Respondents adopt the Statement of the Case provided by petitioner, and agree that the judgment of the court of appeals warrants review by this Court. In declining to enforce the parties' arbitration agreements, the decision below is contrary to the holdings of the two district courts to examine those agreements, to a decision of the United States Court of Appeals for the Third Circuit, to

the congressional policy favoring arbitration adopted in the Federal Arbitration Act, 9 U.S.C. § 1 *et seq.*, and to the decisions of this Court applying that Act. It will produce precisely the waste and inefficiencies that Congress sought to avoid: additional burdens on an already congested federal court system, needless multiplication of litigation costs, and the frustration of privately-negotiated agreements. The significance of this recurring issue warrants a grant of certiorari—or, in light of the plain error committed by the court of appeals, summary reversal.

1. As petitioner has shown, the decision of the Eighth Circuit in this case directly conflicts with the decision of the Third Circuit in *Patten Securities Corp.* v. *Diamond Greyhound & Genetics, Inc.*, 819 F.2d 400 (3d Cir. 1987). The Eighth Circuit declined to enforce the arbitration clauses which the parties had negotiated in the Gas Purchase Agreements because it held that they had been silently superseded by a forum selection clause in the Pipeline Affiliates Agreement.[1] The Third Circuit reached precisely the opposite result in *Patten Securities*, holding that enforcement of an arbitration clause was required notwithstanding the presence (in that case, in the *same* agreement) of a contrary forum selection clause. *Id.* at 407.

The courts of appeals reached these different conclusions because of the different weight each gave to the federal policy favoring arbitration. The Third Circuit held that arbitration clauses enjoy "federal favor." *Id.* It therefore concluded that an arguably conflicting forum selection clause "must be scrutinized carefully, and if doubts arise as to whether [a] dispute is arbitrable or not, such doubts must be resolved in favor of arbitrability." *Id.* In contrast, as the dissent demonstrated, in the

[1] The parties dispute whether the decision also rendered unenforceable the identical arbitration clauses in the Synthetic Gas Transportation Agreements. *See* Pet. 5. That dispute, however, is not relevant to this petition.

Eighth Circuit that federal policy was completely "ignored." Appendix to Petition for Certiorari ("Pet. App.") A-12.

The Eighth Circuit's decision not only creates a conflict among the circuits; it also represents a significant departure from this Court's prior decisions. In *Moses H. Cone Memorial Hospital* v. *Mercury Construction Corp.*, 460 U.S. 1, 24-25 (1983), this Court held that the Federal Arbitration Act constitutes "a congressional declaration of a liberal federal policy favoring arbitration agreements." Therefore, "as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language itself [or otherwise]." *Id.* See also *Shearson/American Express, Inc.* v. *McMahon*, 482 U.S. 220, 226 (1987) ("'we rigorously enforce agreements to arbitrate'") (quoting *Dean Witter Reynolds Inc.* v. *Byrd*, 470 U.S. 213, 221 (1985)). The result below could not have been reached had those principles been properly applied.[2]

2. The significance of the decision extends well beyond its effect on these parties. Arbitration clauses are now frequently included in a wide variety of commercial contracts. These clauses are adopted because, at the time the agreement is signed, the parties believe that arbitration will enable disputes to be resolved more quickly and at less expense than will litigation in federal court, and because they provide greater certainty in commercial relations. Once a concrete dispute arises, however, one

[2] Indeed, the Eighth Circuit's antipathy toward arbitration was such that, although it treated the case as one involving an issue of contract interpretation, it reversed outright the district court's finding that the parties to these agreements intended the arbitration clauses to control. Even if it were proper to ignore the federal policy favoring arbitration, the court of appeals should at a minimum have remanded the case for further factfinding rather than substitute in the course of appellate review its unsupported speculations regarding the parties' intent for the district court's contrary conclusion.

party frequently concludes that its chances of success will be greater in court than before an arbitration panel. If courts fail to adhere to a federal policy favoring the enforcement of arbitration clauses, then parties will always be encouraged to engage in additional rounds of litigation over the arbitrability of disputes—thus defeating the whole purpose of arbitration, exacerbating rather than relieving congestion in the federal courts, lengthening rather than shortening the dispute resolution process, and discouraging parties from agreeing to arbitration in the first place.

This is why the presumption favoring arbitration clauses was established: to provide the certainty of enforcement that enables parties to such agreements to rely upon them, and thus to effectuate the federal policies favoring alternative means of dispute resolution. In the absence of such a presumption, as this case demonstrates, an arbitration clause becomes just one more contractual provision for parties to litigate over in federal court.

3. This case further illustrates the gross inefficiencies that can result when courts refuse to enforce arbitration agreements, and the ways in which such decisions will discourage parties from agreeing to arbitration clauses when they negotiate commercial contracts in the first instance. Two federal district courts, one in North Dakota and one in Texas, held that the Federal Arbitration Act required that the disputes at issue in this proceeding be resolved by separate arbitrations pursuant to the mandatory arbitration clauses included within each of the Gas Purchase Agreements.

Notwithstanding these rulings, Dakota Gasification Company ("Dakota") asked that the four arbitrations be consolidated. The American Arbitration Association, as well as the Chief Judge of the United States Court of Appeals for the Fifth Circuit (who was designated in each contract as the individual to appoint a neutral arbitrator in the event that the party-appointed arbitrators

could not agree), concluded that each of the pipelines was entitled to a separate arbitration of its dispute with Dakota. The parties then proceeded for about a year to resolve through arbitration their outstanding disputes. As can be seen from the following descriptions, significant progress had been made in those proceedings prior to the decision by the court of appeals:

- The arbitration between Dakota and Tennessee was presided over by Judge Clarence Guittard, formerly of the federal bankruptcy court and the Texas appellate bench. Under his supervision, the parties conducted voluminous discovery, exchanging or providing access to hundreds of boxes of documents. Both parties also filed extensive summary judgment motions addressing the principal issues in the case; presented oral arguments to the arbitrators on those motions; and received rulings from the arbitrators.

- The arbitration between Dakota and ANR followed a similar course. Judge Arlin Adams, formerly Chief Judge of the United States Court of Appeals for the Third Circuit, was selected as the neutral arbitrator. Pre-hearing conference briefs, reply briefs, and statements of issues were filed in April and May of 1991. Extensive discovery was accomplished, involving the production of thousands of pages of documents by both sides, responses to numerous interrogatories, and the filing of motions to compel on disputed discovery issues. Under the panel's direction, both ANR and Dakota conducted audits of the other's books and records pursuant to the governing agreements. Each party then moved for summary judgment on several issues, and rulings were issued on August 5.

- In the arbitration between Dakota and Natural, former United States District Judge Frank J. McGarr (N.D. Ill.) was the neutral arbitrator. By the time the Eighth Circuit reversed the district court, the parties had likewise already submitted extensive briefs on summary judgment, the arbitration panel

had ruled, and the parties were beginning the process of discovery concerning the remaining issues.

The decision by the Eighth Circuit has rendered much of those efforts wasteful. The progress made in the arbitration proceedings has been largely negated, and the cases have been returned to district court to start afresh. Even if some of the progress before the arbitration panels is usable in federal court, the issues will be reviewed de novo by the court, and it will certainly amount to a substantial waste of time and resources.

This result is exactly the opposite of what Congress intended when it enacted the Federal Arbitration Act, and what the parties intended when they entered into these agreements. The expense for all parties has been multiplied several times over, and the federal courts will now be required to rehear cases that belong in, and were already being adjudicated in, arbitration proceedings. The only beneficiary is Dakota, which now has the opportunity to relitigate these issues, including the issues it already lost in summary judgment proceedings before the arbitrators, and to do so in a State in which it is the principal private employer—precisely the result the parties sought to avoid when they agreed upon arbitration.

Bouncing parties back and forth between arbitration and litigation defeats all the federal policies underlying the Federal Arbitration Act. Such a result is inevitable, however, if appellate courts feel free to reverse a district court's enforcement orders based on their own perceptions of the parties' intent, without regard to any policy or presumption favoring arbitration. Because appellate courts will generally be issuing decisions reviewing such district court orders many months, if not years, after those orders are entered, the likelihood of their disrupting ongoing arbitration proceedings, generating uncertainty regarding the validity of those proceedings, and perhaps, as here, nullifying them entirely, is particularly strong.

That is what happened in this instance, and what will continue to happen if this decision is permitted to stand.

4. Finally, because the decision below is plainly in error, and contradicts clear prior holdings of this Court favoring the enforceability of arbitration agreements, summary reversal is appropriate.[3]

The Pipeline Affiliates Agreement expressly precludes the interpretation relied on by the court of appeals. That agreement provided that the Gas Purchase Agreements were to be reinstated "on the *same terms* as were in effect prior to such termination and reinstatement." Pet. App. H-2 (emphasis added). As noted by Judge Magill in dissent, the arbitration clause "clearly was a term in effect prior to reinstatement" and therefore remained part of the Gas Purchase Agreements when those agreements were reinstated. *Id.* at A-12. In contrast, the forum selection clause of the Pipeline Affiliates Agreement, upon which the court of appeals relied in displacing the arbitration clauses of the Gas Purchase Agreements, was never part of the Gas Purchase Agreements or the Synthetic Gas Transportation Agreements. Indeed, that clause by its express terms applied only to lawsuits brought "to enforce the rights of the Secretary *hereunder*," *i.e.*, lawsuits arising out of the Pipeline Affiliates Agreement. *Id.* at H-10 (emphasis added).

Thus, the dissent's reading of the contracts was plainly correct: the Pipeline Affiliates Agreement authorized lawsuits in federal court for the enforcement of the rights granted by *it* to the Secretary of Energy, while preserving the arbitration clauses in the Gas Purchase Agreements and the Synthetic Gas Transportation Agreements for disputes arising out of those Agreements. Because this lawsuit was expressly brought under the Gas Purchase

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[3] *See* Sup. Ct. R. 16.1; *cf. Wyrick* v. *Fields*, 459 U.S. 42 (1982); *Board of Educ.* v. *McCluskey*, 458 U.S. 966 (1982); *Smith* v. *Arkansas State Highway Employees*, 441 U.S. 463 (1979); *School Dist.* v. *United States*, 433 U.S. 667 (1977); R. Stern et al., *Supreme Court Practice* § 5.12 (6th ed. 1986) (collecting cases).

Agreements and the Synthetic Gas Transportation Agreements, the arbitration clauses of those agreements must apply.

Notably, the panel cited no evidence whatever—intrinsic or extrinsic—to support its contrary conclusion that the Pipeline Affiliates Agreement was meant to modify the Gas Purchase Agreements.[4] Moreover, by eliminating the arbitration clauses from the Gas Purchase Agreements, the court of appeals undercut one of the principal findings made by the district court in 1985 when it approved the Secretary of Energy's 1985 exercise of his right under the Pipeline Affiliates Agreement to reinstate the Gas Purchase Agreements. In so ruling, the district court held that:

> The United States has succeeded to the contract rights of the "partnership," and has also assumed the duties of the partnership under the [Gas Purchase Agreement]. No greater or lesser duty is imposed upon the United States than created by the contract upon the partnership.

United States v. *Great Plains Gasification Assocs.*, Civ. No. A1-85-237 (D.N.D. Jan. 14, 1986) (Appendix to Brief of Respondents 16a), *aff'd*, 819 F.2d 831 (8th Cir. 1987).[5]

---

[4] The one fact relied upon by the court of appeals—that the Gas Purchase Agreements provide that a purchaser is entitled to the rights of its predecessor—is irrelevant. The only right given Dakota's "predecessor" (the Secretary of Energy) under the forum selection clause was the right to have disputes arising out of the Pipeline Affiliates Agreement litigated in court. As Judge Magill noted, the Pipeline Affiliates Agreement was not assigned to Dakota, Pet. App. A-13 n.5, but even if it had been, it could not grant Dakota more rights than it granted the Secretary.

[5] It is interesting to note that in affirming the district court's 1985 decision, the court of appeals did not find that the Gas Purchase Agreements had been modified in any respect by the Pipeline Affiliates Agreement. Indeed, the Court accepted for purposes of analysis the district court's finding that Illinois law applied. If the terms of the Pipeline Affiliates Agreement had modified the Gas Purchase Agreements, federal law would arguably apply.

Thus, a straightforward reading of these contracts requires the enforcement of their arbitration clauses. But even if there were any doubt or ambiguity—and nothing in the contracts creates any ambiguity—it would have to be resolved, as the *Patten* court held, by reliance on the strong federal policy favoring enforcement of arbitration agreements. The clarity of the contractual language, along with that established federal policy, eliminate any argument on the merits in favor of the judgment and therefore make this an appropriate case for summary reversal.

CONCLUSION

For the foregoing reasons and those stated in the petition for certiorari, the petition should be granted. In the alternative, the decision of the court of appeals should be summarily reversed.

Respectfully submitted,

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October 9, 1992

APPENDIX

APPENDIX

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NORTH DAKOTA
SOUTHWESTERN DIVISION

Civil No. A1-85-237

UNITED STATES OF AMERICA, *et al.*,
Plaintiffs,

vs.

GREAT PLAINS GASIFICATION ASSOCIATES, *et al.*,
Defendants,

and

NATURAL GAS PIPELINE COMPANY OF AMERICA,
Third-Party Plaintiff,

vs.

FEDERAL FINANCING BANK,
Third-Party Defendant.

MEMORANDUM AND ORDER

[Filed Jan. 14, 1986]

Plaintiffs have moved for summary judgment on all four counts of the complaint:

1. Foreclosure

2. Declaratory action regarding validity of gas purchase contract.

3. Injunctive relief requiring payments for gas at contract rates.

4. Money Judgment for unpaid "contract" rates on gas tendered to defendant Natural.

The motions are resisted.

FACTS

GPGA, a partnership composed of: ANR Gasification Properties Co.; MCN Coal Gasification Co.; Pacific Synthetic Fuel Co.; Tenneco SNG Inc.; and Tranco Coal Gas Co., invested approximately $550,000,000.00 of its capital and $1,500,000,000.00 borrowed from the Federal Financing Bank (FFB) in the construction of a plant designed to produce "natural gas" from lignite coal deposits in North Dakota.

Four "pipeline" companies, Natural Gas Pipeline Co. of America; ANR Pipeline Co.; Tennessee Gas Pipeline Co.; and Transcontinental Gas Pipe Line Corp., entered into "take or pay" gas production contracts in various percentages of plant production which totalled 100%. These contracts obligated the pipeline companies to a payment rate substantially above market price for the gas produced, which price was to reduce in periodic increments over a 25-year period.

To secure repayment of the loan, the Partnership gave a mortgage to FFB and included as security the "subsidy" purchase prices included in the gas purchase contracts.

The Department of Energy of the United States guaranteed repayment of the loan to the FFB and entered in separate contracts with the "pipeline companies" defining the rights of the parties should the partnership default.

The security arrangements for the loan also provided for a trustee to assume possession and operation of the pledged assets in the event of default.

The "pipeline companies" were either affiliated or in common ownership with four of the five partners in the "partnership."

The financing arrangements were in substance:

1. The "partnership" limited its liability to the original investment.

2. To demonstrate a "cash flow" feasibility, the "subsidy rate" gas purchase contracts were signed, with the requirement that the "subsidy price" be spreadable and chargeable to the gas consumer customers of the pipeline companies.

3. The gas purchase contract rights were included in the security package given to the FFB and to the loan guarantor, the United States.

The plant was an experimental process. The gas produced, if any, would be produced at a price conceded to be higher than market price from other sources at time of initial production.

The impetus for construction and for the execution by the pipeline companies of the gas purchase contracts was the "crisis" in the mid-1970's created by OPEC. The project was part of a program supported by the United States to reduce dependence upon foreign supplies of fossil fuel energy.

The "assumptions" and "beliefs" behind the business judgment of the contracting parties were that the energy supplies available to the United States consumers would continue to be "squeezed" by foreign producers, that prices would continue to rise, that sources of natural gas would or might become unavailable to distribution companies and that with these assumptions, the investment by way of the subsidy price structure during the early years of the plant operation was warranted through provision of a dependable supply source at a more favorable price during the later years of the initial 25-year period.

The predictions of future conditions turned out to be inaccurate.

The plant was constructed and it worked.

When the Department of Energy (DOE) refused an additional infusion of capital, the "partnership" announced that it could not meet the principal and interest payment due and "defaulted" on the mortgage obligation.

On August 1, 1985, the "partnership" relinquished control of the plant and its assets to the trustee.

During July and August of 1985, various officials of the DOE made public statements regarding the economic viability of the plant. These statements were made in justifying the refusal to inject additional capital and also after default had occurred. The gist of these statements can be summarized as:

> "The plant cannot be economically justified in view of market realities as opposed to initial market projections; it would be wrong to spend additional tax money to operate it; if we continue its operation at all, it will be for
>
> 1. a few days
> 2. a few months
> 3. until the summer of 1986
> 4. during the period income exceeds operating "expense."

After August 1, 1985, the plant continued in operation and gas was delivered to the pipeline companies. Three of the four have at times paid less than the contract price. The fourth pipeline company, ANR, has paid the contract price.

The contract rate is currently approximately 2 1/2 times the market rate.

Under present Federal Energy Regulatory Commission (FERC) orders, the pipeline companies are authorized to spread the contract rate back to their customers.

The DOE exercised the right afforded the United States in the agreements between it and the pipeline companies to "reinstate" the gas purchase contracts and did so by notice dated August 21, 1985.

Considering the defenses raised by the defendant pipeline companies, the relevant contract provisions are:

GAS PURCHASE AGREEMENT

ARTICLE XIX
ABANDONMENT

1. Seller shall have the right, with the consent of the Secretary so long as the mortgage is in effect, to abandon its services hereunder at any time following the determination, made by the seller in its sole good faith judgment,
that it is not feasible to continue such service for technological reasons,
cost overruns in excess of estimate of costs of construction of the gasification plant or related facilities,
government action, whether by legislation, regulation, amendment of authorizations or otherwise, law suits,
force majeure including all causes or contingencies described in section 1 of article IX hereof, or any other reason, whether similar or dissimilar to those enumerated hereinabove.

ARTICLE XVII
APPLICABLE LAW

This agreement shall be governed by and be interpreted in accordance with the law of the State of Illinois.

STATEMENT OF PURPOSE

Whereas seller desires to demonstrate the feasibility of manufacturing synthetic gas from coal,

and whereas, buyer desires to supplement and augment its reserves with a long term supply of gas by purchasing such gas for resale to its customers;

PAYMENT OBLIGATIONS

In return, Buyer *believes* it will be assured a long term supply of gas on equitable and reasonable terms and conditions. Further, it is recognized that buyer, in making its commitment to purchase such gas will rely upon (1) a finding by the FERC that buyers execution of this agreement is a prudent act and (2) advance assurances from the FERC that the charges hereunder may be reflected in Buyer's rates. Recognition of the foregoing by Buyer and Seller, therefore, constitutes the basis upon which Buyer is willing to commit to the purchase of the Gas and Seller is willing to proceed with the construction of the gasification plant. If however, a subsequent action by the FERC should remove from the buyer the right to reflect any or all charges under this agreement, it is hereby agreed as follows:

(a) Notwithstanding the provisions of Articles X and XI of this agreement, Buyer shall be obligated to make payments to seller in accordance with such articles only to the extent that the FERC allows buyer to charge the amounts described therein to its customers on a rolled-in basis pursuant to the purchased gas cost adjustment provision of Buyers FERC Gas tariff or on a substantially equivalent basis which provides for the charging of such amount.

One of the pipeline companies invoked the provisions of Section 2-609 of the U.C.C., "Right to adequate Assurance of Performance." The Department of Energy, in response, indicated that it would operate the plant so long as income exceeded cost of production.

It also appears that Illinois has adopted Section 2-609 of the U.C.C.

That the United States did not comply with the procedural requirements of the foreclosure statutes of the State of North Dakota and served no statutory "notice of foreclosure" prior to suit.

That the economic impact of plant closure upon the state of North Dakota and its citizens and the economic impact of the contract rates upon the pipeline company consumers are not proper matters for consideration by the court; rather, these matters may be appropriate for political or legislative action but not as a basis for contract construction.

That the motives of ANR in supporting contract validity are equally irrelevant.

The motion and objections relating to the foreclosure raise issues which must be separated into two categories. The first category creates a condition precedent to either the United States or the trustee having standing to prosecute the action.

Both GPGA and Pacific argue that plaintiff has not followed the steps set forth in the mortgage for substitution of a trustee, and that Berton J. Roth, the purported substitute trustee, is thus not lawfully in possession of the property, and by inference, lacks standing to appear as a plaintiff.

The filings show the following:

Exhibit "B" to document #177 (Roth Declaration)

a) Letter to Citibank, copied to Federal Financing Bank and GPGA, stating that the Secretary appointed Roth successor trustee under section 8.06 of the mortgage

b) Roth's acceptance of that appointment

(c) Memo to Roth notifying him that DOE was appointed as successor trustee

(d) DOE's acceptance of that appointment, and

(e) A delegation of DOE's authority as successor trustee to Roth

The letter, (a) above, was sent to GPGA by First Class Mail and GPGA does not specifically deny its receipt. (*see* McKinney declaration, attachment to document #97)

GPGA argues (document #95 at page 4) as does Pacific (document #97) that notice was not received from Citibank that it had resigned or been removed as trustee.

Section 8.06 of the mortgage provides that the Secretary is to provide notice of removal to the trustee and to GPGA.

The record reveals that the required notice was given, and by the appropriate entity.

GPGA also argues that a supplemental indenture has not been executed in accordance with 9.02 (b) (2) of the mortgage, and that such is required to authorize a successor trustee to act. The section is permissive—it states that GPGA may execute a supplemental indenture to evidence a succession in trusteeship. Nowhere does a requirement exist that such an act be done.

GPGA finally argues that under 10 C.F.R. § 796.60(f) "The guarantee agreement shall provide that, upon payment of the guaranteed loan by the Secretary, the holder shall transfer and assign to the Secretary, all rights held by the holder in the guaranteed loan . . . Upon such payment and assignment, the Secretary shall be subrogated to the rights of the recipient of the payment and shall have the superior rights in and to the property acquired from the recipient of the payment."

Evidence is required that payment and transfer of rights of the FFB have occurred.

In response thereto, Plaintiff contends that Roth exhibit VI provides sufficient uncontroverted evidence of the subrogation status of the Secretary. The court agrees and finds no genuine issue of material fact present.

Roth is the duly acting trustee and in lawful possession of the plant.

Turning next to the issues raised on the foreclosure count itself, there is a conflict in authorities regarding the applicability of state law and procedures in effecting the remedy of foreclosure.

Both Plaintiff and GPGA cite *U.S. v. Kimbell Foods*, 440 U.S. 715, 99 S.Ct. 1448 (1979) in support of their positions. *Kimbell Foods* addressed whether lien priority is to be determined under state or federal law when liens are held both by the Small Business Administration (SBA) or the Farmers Home Administration (FmHA) and by private parties. The Court first determined that federal law governs questions involving the rights of the United States arising under nationwide federal programs. Absent a congressional directive, whether to adopt state law or to fashion a nationwide federal rule is a matter of judicial policy "dependent upon a variety of considerations always relevant to the nature of the specific governmental interest and to the effects upon them of applying state law." *Id.*, 440 U.S. at 728, 99 S.Ct. at 1458. Those considerations include whether the nature of a federal program necessitates a nationally uniform body of law, whether application of state law would frustrate specific objectives of the federal program, and the extent to which application of a federal rule would disrupt commercial relationships predicated on state law.

Plaintiff first argues that the balancing test outline in *Kimbell Foods* need not be applied because the statute under which the loan guarantee was made, 42 U.S.C.

¶ 5919 (g) (2), precludes application of state law. That statute provides:

> If the Secretary makes a payment under paragraph (a) of this subsection [providing for payment by the Secretary should a borrower default], the Secretary shall be subrogated to the rights of the recipient of such payment (and such subrogation shall be expressly set forth in the guarantee or related agreements), including the authority to complete maintain, operate, lease, *or otherwise dispose of any property acquired pursuant to such guarantee* or related agreements, or any other property of the borrower (of a value equal to the amount of such payment) to the extent that the guarantee applies to amounts in excess of the estimated project cost under subsection (c) (2) (B) of this section, *without regard to* the provisions of the Federal Property and Administrative Services Act of 1949, as amended [40 U.S.C.A. ¶ 471 *et seq.*] . . . or *any other law*, or to permit the borrower, pursuant to an agreement with the Secretary, to continue to pursue the purposes of the demonstration facility if the Secretary determines that this is in the public interest. The rights of the Secretary with respect to any property acquired pursuant to such guarantee or related agreements, shall be superior to the rights of any other person with respect to such property.
>
> [Emphasis added].

Plaintiff argues that this statute makes state law inapplicable to a foreclosure action, since it states the Secretary may act without regard to "any other law." GPGA argues that the statute is more logically construed as simply defining the Secretary's authority to manage secured property upon the borrower's default, rather than as defining the rights of the parties to the mortgage *vis a vis* each other. The court has found no case law construing this provision. The court finds GPGA's interpretation

to be more logical than the government's. The statute refers specifically to property management laws; to infer from the statute that it is intended to preclude application of state foreclosure laws requires that the language "without regard to . . . any other law" be very broadly interpreted.

If section 5919 (g) (2) does not specifically preclude application of state foreclosure law, the *Kimbell Foods* factors must be considered. Though the court has found no cases applying the *Kimbell Foods* factors to this particular federal loan guarantee program, there are a number of cases applying those factors to other federal loan guarantee programs. Those cases do not reach consistent results. The primary case upon which Plaintiff relies, *U.S. v. Victory Highway Village, Inc.*, 662 F.2d 488 (8th Cir. 1981), decides a question of remedies available upon default of a federally held or insured loan without mentioning *Kimbell Foods*.

In *Victory Highway Village*, the Eighth Circuit held that Minnesota's redemption statute did not apply to foreclosure of federally held or insured loans under the National Housing Act. The court reasoned that the right to redemption after foreclosure is purely statutory, and that since there is no federal statute granting a right to redemption, that right could not exist. In an earlier opinion, *Victory Highway Village, Inc. v. Weaver*, 634 F.2d 1099, 1101 (8th Cir. 1980), the court discussed *Kimbell Foods*, but found it unnecessary to decide whether federal law or state law governed interpretation of a guarantee under an SBA loan. Another Eighth Circuit case, *U.S. v. Kukowski*, 735 F.2d 1057 (8th Cir. 1984), considered *Kimbell Foods* and held that rights of a guarantor on an SBA loan were to be determined with reference to the Uniform Commercial Code, since when state law is based on a uniform statute, there is little concern that the federal interest in uniformity of law will be hindered by application of state law. In *U.S. v. Missouri*

Farmers Ass'n, Inc., 764 F.2d 488 (8th Cir. 1985), the court determined that FmHA regulations rather than state law governed release of FmHA liens since state law would conflict with the federal interest present in the FmHA loan program. In a case decided before *Kimbell Foods, U.S. v. Thompson*, 438 F.2d 254 (8th Cir. 1971), the court held that state law determined priority rights involving a federally insured loan, while federal law determined remedies available to the federal government to enforce its security interest.

Cases from other circuits supporting Plaintiff's position include the following. In *U.S. v. Scholnick*, 606 F.2d 160 (6th Cir. 1979), federal law was applied to determine priority in an action to foreclose a mortgage held by H.U.D. In *U.S. v. Med O Farm, Inc.*, 701 F.2d 88 (9th Cir. 1983), a state law barring enforcement of a "due on sale" clause was held not to apply to a loan made by FmHA. In *U.S. v. Stadium Apartments*, 425 F.2d 358 (9th Cir. 1970), state redemption statutes were held not to apply to a mortgage guaranteed by the Federal Housing Authority.

Cases from other circuits supporting GPGA's position include the following. In *U.S. v. Irby*, 618 F.2d 352 (5th Cir. 1980), the court held that state real property law governed an action to recover a deficiency judgment against guarantors under an SBA loan. In *U.S. v. Dismuke*, 616 F.2d 755 (5th Cir. 1980), the government was required to follow state law procedures for judicial confirmation of a foreclosure sale prior to obtaining a deficiency judgment against guarantors on an SBA loan. In *Chicago Title Insurance Co. v. Sherred Village Associates*, 708 F.2d 804 (1st Cir. 1983), the court held that state law governed a question of relative priority of a mechanic's lien and a mortgage insured by H.U.D.

Eighth Circuit precedent would support a ruling that Plaintiff is not required to comply with North Dakota foreclosure law. However, there is no precedent involv-

ing this particular loan guarantee program, and the court feels a determination under the *Kimbell Foods* test presents a close question. Since the number of loans guaranteed under this program is apparently small, there is little need for a "nationally uniform body of law." Application of state law might be considered to "frustrate specific objectives of federal programs," if those objectives are considered to include federal operation of the project upon default. Finally, though there may be a strong state interest in "insuring that commercial relationships predicated upon state law are not disrupted," this project is unique and this foreclosure may bear little resemblance to foreclosures of other real property.

If state law were found to apply under the balancing test of *Kimbell Foods*, there is a question of whether GPGA waived its rights under state law by virtue of section 13.03 of the mortgage agreement, which provides:

> To the full extent it may legally do so, Borrower [GPGA] hereby expressly waives any and all rights of redemption from sale under order or decree of foreclosure of this Mortgage, on behalf of Borrower as well as on behalf of each and every person acquiring any interest in or title to Mortgaged Property, by, through, or under Borrower, either subsequent to the date hereof, or prior to the date hereof and, Borrower, for itself, and for all that Borrower may legally bind, agrees that when such a sale is held under any decree of foreclosure of this Mortgage, upon consummation of said sale, the sheriff of the county where the real estate which is part of the Mortgaged Property is situated, or other officer who made such sale, or his successor in office, is hereby authorized immediately to execute and deliver to the purchaser at such sale a deed describing and conveying the premises purchased, showing the amount paid therefor, or if purchased by the person in whose favor the order or decree is entered, the amount bid therefor.

Section 13.04 of the Mortgage provides:

> This Mortgage and the rights and obligations hereunder shall be governed by and construed and interpreted in accordance with the federal laws of the United States.

GPGA, citing two early North Dakota cases, *Smith v. Grilk*, 250 N.W. 787 (N.D. 1933), and *Fargo Building & Loan Ass'n v. Rice*, 262 N.W. 345 (N.D. 1935), argues that the right of redemption is sacrosanct under state law, and that the mortgage provision thus is not an effective waiver of the right of redemption. *Fargo Building & Loan Ass'n* held that a mortgagee could lawfully possess the mortgaged property under terms of the mortgage agreement even though the mortgagor may have had a right to the rents and profits from the property. *Smith v. Grilk* was decided shortly after enactment of a redemption statute, and held that the statute was so inconsistent with waiver of the right to redemption that it repealed recognition of the right to contract for waiver of the right of redemption. The instant case is different from the cases cited: GPGA can hardly have been unaware of the waiver provision when the mortgage was executed, and the terms of this mortgage were *negotiated* among the parties. The court has little sympathy for the waiver argument, given the clear language of the mortgage. Moreover, if federal law governs foreclosure of the mortgage, state law which does not recognize waiver of the right of redemption need not be considered.

Several options are presented to the court. All have merit. These options are:

1. Follow the Eighth Circuit precedents and hold that federal law defines the remedy;

2. Analyze the factual situation under the test set out in *Kimbell Foods*, and hold that under that test state law need not be applied;

3. Hold state law applicable under *Kimbell Foods*, but find that the waiver contained in the mortgage contract is effective and not violative of public policy as the situation is not analogous to a homestead mortgage.

4. Hold that state law is applicable and that statutory notice and right of redemption apply.

The obvious fact that, as a practical matter, a statutory notice and extension of a right of redemption would likely serve no purpose cannot be the basis of decision.

Based upon the contractual provision in the mortgage agreement, particularly 13.03 and 13.04, the unique character of the property and program involved, the court finds that the holding in *U.S. v. Victory Highway Village, Inc.*, and, in addition, the application of the test measurements in *Kimbell Foods* compel a finding that state law is not applicable and that Plaintiffs are entitled to summary judgment for foreclosure.

Turning next to the motion on the second cause of action, the declaratory proceeding, the court finds and concludes that there are no issues of material fact and that the motion for summary judgment is properly before the court.

No dispute exists that the contracts were executed, the plant built, FERC approval obtained, gas produced and tendered, the mortgage obligation defaulted on by the partnership, possession and control of the plant delivered to the trustee, the guarantee obligation of the United States triggered by the default and notice given by the United States of its "reinstatement" of the gas purchase agreement.

It is not disputed that various representatives of the DOE made statements concerning the possible closure of the plant.

No one disputes that an unbridgeable chasm exists between the economic projections of the contracting par-

ties and the economic realities of 1985, in that supplies appear to have increased and prices declined rather than the opposite.

The defendants Natural Gas Pipeline Co., Tennessee Gas, and Transcontinental Gas in various combinations raise as defenses to the contract the following:

1. That the conduct of the United States precludes the enforcement of the gas purchase agreements, as such conduct creates:

   a) a basis for repudiation under the provisions of U.C.C. 2-609;

   b) a failure of consideration as the government will not "commit" to a 25-year term;

   c) a "frustration of purpose" as the government indicates an intent to not perform for a period of 25 years, and FERC action has weakened the position of the pipeline companies.

2. That the contract was entered into under "mutual mistake" of the contracting parties as to economic conditions.

3. Waiver and Estoppel.

4. The output of production is excessive because higer than anticipated.

The court finds the defenses raised to be without merit.

The United States has succeeded to the contract rights of the "partnership," and has also assumed the duties of the partnership under the contract. No greater or lesser duty is imposed upon the United States than created by the contract upon the partnership.

The court finds the contract, while unusual, to be clear and unambiguous. If gas is produced by the plant, the pipeline companies must pay for all gas produced, with-

out limitation as to quantity, so long as the gas meets the contract specifications and so long as FERC allows the cost to be spread to the customers of the pipeline companies.

The seller of the gas, under the provisions of Article XIX occupies a somewhat unusual position. It is to this position that the United States has moved. The clear language provides that the seller has the right to cease production *for any reason*, based upon its sole good faith judgment. At the time the contract was prepared and executed, the seller and the buyers had interlocking ownership and control, which to the court negates any claims of overreaching or unconscionability. This position is again reflected in section 5.02 of "Partners Consent and Agreement."

For purposes of this decision, U.C.C. section 2-609 under Illinois law provides no valid defense to the three defendant pipeline companies. If the statements of the DOE officials do provide a basis for seeking reasonable assurance of performance, the response by the DOE goes beyond the obligations imposed upon the United States by the contract language. The defendants cannot claim a repudiation, or an insufficient assurance, as a matter of law when the assurance given assumes a greater burden than the underlying contract. *Pittsburgh-Des Moines Steel Co. v. Brookhaven Manor Water Co.*, 532 F.2d 572 (7th Cir. 1976) (party may not demand more assurance than that to which it is entitled under the contract); and *Gardner Engineering Corp. v. Page Engineering Corp.*, 484 F.2d 27 (8th Cir. 1973) (party not entitled to receive more assurance than that demanded). *See also Louisiana Power & Light Co. v. Allegheny Ludlum Indus., Inc.*, 517 F. Supp. 1319 (E.D.La. 1981), in which the district court ruled that a *late and* qualified offer of performance cannot be considered adequate assurance under section 2-609. *Id.* at 1323. We can analogize from *Louisiana Power* that a timely assurance of super-

contractual performance is adequate. This court also notes that the provisions of the Uniform Commercial Code are to be broadly interpreted with an eye toward promoting its underlying purposes and policies. *U.C.C. section 1-102(1)*. This court declines to adopt the mirror-image approach asserted by the defendants.

A review of the draftsmen's Comments to section 2-609 leads to the conclusion that to give to this section the effect sought by the defendants would be a perversion of the purpose and intent of the law. Its commercial purpose is to allow a buyer or supplier to take steps to guarantee performance where non-performance would create economic loss and alternate solvent suppliers or buyers are available. There is no question that in this case non-performance confers an economic benefit upon the customers of defendant rather than a hardship, and the request for assurance of performance is a subterfuge.

The balance of the matters raised in defense to the motion are without merit.

The change in economic reality as opposed to economic projections may have a bearing upon the wisdom of the contracting parties, but does not render the contract unenforceable. The parties found it desirable to give the seller a list of escape routes, including "any other reason not enumerated hereabove." They also found it desirable, or necessary to satisfy the lender, to limit the options of the buyers, at the expense of their customers. The basic escape route provided buyers is through FERC disapproval. It is possible that at some future date FERC action may provide an excuse for non-performance, but under the undisputed facts, the United States as successor in interest to the FFB and the "partnership" holds a valid and enforceable contract right.

The court treats this matter as a commercial contract dispute. The request in count 3 for the injunctive relief appears premature. The court will not grant injunctive

relief and clothe the plaintiff with the right to invoke the contempt powers of the court without a further showing of necessity.

Plaintiffs have moved for summary judgment of damages due by virtue of non-payment or under-payment by Natural. In ruling in favor of plaintiffs on count 2, the determination of contract rights, the court has found the defendant pipeline companies liable to the plaintiff for the difference between the contract price and the market value price actually paid. As the computation varies and increases each month and the obligation is continuing, the court requests that plaintiff provide the court with its computation of the amounts due from Natural for all gas delivered or tendered through the month of December, 1985. The complaint does not seek a money judgment against other defendants. If objections are made to the computations, an evidentiary hearing will be scheduled thereon. In connection therewith, it is the position of the court that any future action by FERC in prohibiting spreading of contract price gas through to consumers can only operate to excuse performance after the date of such order and not relieve defendants of the duty to make payment for gas tendered or delivered, the costs of which could, at the time of delivery, have been spread through to consumers.

IT IS ORDERED:

The motion of the plaintiffs for summary judgment for foreclosure is *granted*

The motion for summary judgment determining the validity of the Gas Purchase Contract is *granted*

The motion for injunctive relief in *denied*

The motion for money damges judgment is held in abeyance pending submission of current statements of account, as provided above

Dated this 14th day of January, 1986, at Bismarck, North Dakota.

/s/ Patrick A. Conmy
PATRICK A. CONMY
Chief Judge
United States District Court

[Entered Jan. 14, 1986]